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CHARLES ELMORE CROPLEY
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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1942.

EDISON BROTHERS STORES, INC.,
Petitioner,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 916

PETITION FOR A WRIT OF CERTIORARI

To the United States Circuit Court of Appeals
for the Eighth Circuit

and

BRIEF IN SUPPORT THEREOF.

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No. .....

PETITION FOR WRIT OF CERTIORARI.

To The Honorable Chief Justice And Associate Justices Of The Supreme Court Of The United States:

Your petitioner, Edison Brothers Stores, Inc., a corporation, respectfully shows to this Honorable Court the following:

A.

SUMMARY STATEMENT OF THE MATTER INVOLVED.

PRELIMINARY STATEMENT.

This case arose on cross appeals taken from a decision of the United States Board of Tax Appeals entered on November 25, 1941 (R. 26-34), and reported in 45 B. T. A. 472. The matters in controversy are alleged deficiencies in federal income taxes for the calendar years 1935 and 1937 in the amounts of $1,553.74 and $10,312.15, respectively. The Commissioner was appealing from that por-

tion of the Board's decision which held that there was no deficiency for 1935, and your petitioner, Edison Brothers Stores, Inc., was appealing from so much of the Board's decision as found that there was a deficiency for 1937. The case came to the Circuit Court of Appeals for the Eighth Circuit on cross petitions for review (R. 34 and 40), duly filed by the respective parties pursuant to the provisions of Sections 1141 and 1142 of the Internal Revenue Code, and consolidated for purposes of record, briefing, hearing and decision by order of that Court entered March 7, 1942 (R. 49-50). The judgment of the Circuit Court of Appeals rendered on February 3, 1943 (R. 69-70), reversed the decision of the Board with respect to its finding of no deficiency for the year 1935, and affirmed the Board's decision with respect to its finding of the deficiency asserted for the year 1937. The opinion of the Circuit Court of Appeals is printed on pages 56-68 of the Record.

QUESTIONS PRESENTED.

The questions presented are, first, whether petitioner realized taxable income in either or both of the years involved from the sale by it of shares of its own capital stock to certain of its employees pursuant to employees' stock subscription plans; and, second, whether the company was entitled to deduct the fair market value of certain shares of its own stock which it transferred to its general counsel in 1935 in payment of a bill for services rendered.

FACTS.

There is no dispute as to the facts, all of them having been agreed to by the parties in a Stipulation of Facts filed with the Board of Tax Appeals at the time the case was heard (R. 18-26). Briefly summarized, they are as follows:

Edison Brothers Stores, Inc., was incorporated on March 13, 1929, under the laws of the State of Delaware. A few weeks before the actual incorporation, however, the five Edison brothers, who were the founders and original incorporators of the company, entered into an underwriting agreement with a brokerage house whereby they subscribed to the entire issue of its common stock, consisting of 100,000 shares of no par value, but agreed that they would immediately resell, through the underwriters, 5,000 shares to the company for the purpose of sale and distribution to its employees, and another 20,000 shares to the general public. Thus, in accordance with this preincorporation agreement, the company immediately acquired 5,000 shares of its own stock, at a price to it of $15.00 per share, which it designated as "Capital stock purchased for resale to employees" (R. 19).

Thereafter, during the same year, a substantial portion of this stock was allotted to certain key employees, under a stock subscription plan, at a price of $15.00 a share, payable in installments over a period of time. Subsequently, in 1932, at the depth of the depression, the company voluntarily reduced the original subscription price from $15.00 to $7.50 a share to compensate for the drastic decline in its market value, this adjustment being made on all shares originally subscribed for, except, of course, those for which subscriptions had been canceled. Those employees who had overpaid on the basis of this adjustment were given the option of taking a cash refund or additional shares at the reduced price. This resulted in the issuance of nearly 200 more shares to such employees. Another 760 shares were given to employees in 1933 in the form of bonuses (R. 19-20).

During the year 1935 the company allotted and sold 980 shares of this same stock to certain of its employees at a price to them of $25.00 a share, although the market

price at the time of the sale was $30.00 a share (R. 20). This allotment was likewise made pursuant to an employees' stock subscription plan, the terms of which are fully set forth in Exhibit B of the stipulation of facts (R. 22-24). At about the same time the company transferred another 100 shares of its stock to its general counsel, Mr. George Frankenthaler, of New York City (who was and still is also one of the directors of the company) in payment of a $3,000.00 bill for services rendered (R. 20).

In the early part of 1937, pursuant to a reorganization of the corporation's capital structure, its common stock was split up on a basis of three shares of new $2.00 par value common stock for each one share of the old no par common, thus reducing the company's cost to $5.00 per share (R. 21). Later in the year the company allotted and sold 3,660 shares of this new stock to its employees at a price of $15.00 a share, pursuant to another employees stock subscription agreement (R. 21), a form of which appears as Exhibit C of the stipulation of facts (R. 25).

The Commissioner asserted deficiencies in income taxes for the years 1935 and 1937 (R. 7 and 14) on the ground, first, that the company should have included as taxable income in those years the difference of $10.00 a share between the price at which it acquired those shares at the time of its incorporation and the price at which they were allotted and sold to its employees under the stock subscription plans, and, second, that the company was not entitled to deduct the full market value of those shares which it used in 1935 to discharge its obligation to its general counsel and director for services rendered, but was limited to a deduction of the amount which it had paid for those shares.

Petitioner filed petitions to the United States Board of Tax Appeals for a redetermination of the deficiencies for both years (R. 3 and 12), and, as already indicated, the Board decided these issues in favor of the taxpayer for

the year 1935 and in favor of the Commissioner of Internal Revenue for the year 1937; and the Circuit Court of Appeals has reversed the Board for the year 1935 and has affirmed it for the year 1937, having decided in favor of the Commissioner for both years.

COMMISSIONER'S POSITION.

The Commissioner based his determination of deficiencies on the ground that, in the acquisition of these shares at the time of its incorporation and the subsequent disposition thereof to its employees in 1935 and 1937, petitioner was dealing in its own shares as it might in the shares of another corporation within the meaning of Article 22 (a)-16 of Treasury Regulations 86 and 94 purporting to interpret the meaning of Section 22 (a) of the Revenue Acts of 1934 and 1936.

PETITIONER'S POSITION.

The position which petitioner has maintained throughout these proceedings is:

(1) That the sale by a corporation of shares of its own capital stock which it had previously acquired and held in its treasury is a purely capital transaction resulting in the acquisition of capital and not income.

(2) That such a sale is just as much a capital transaction as the sale of authorized but unissued stock; and that therefore a corporation cannot realize taxable gain from such a sale of treasury stock.

(3) That the prior Regulations which so held for over fourteen years were not only a proper interpretation of Section 22 (a) but were given the force and effect of law by the repeated re-enactment by Congress of Section 22 (a) without change.

(4) That in so far as the amended Regulations promulgated under the Revenue Acts of 1934 and 1936 purport to

change the prior interpretation of Section 22 (a) they must be held invalid as an administrative attempt to usurp the legislative function of Congress.

(5) That petitioner was not in any sense dealing in the shares of its own stock as it might in the shares of another corporation and that hence the amended Regulations, even if valid, have no application to the transactions here involved.

B.

JURISDICTION.

Jurisdiction to review the judgment of the Circuit Court of Appeals in this case is conferred upon this Court by the provisions of Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 43 Stat. 938 [28 United States Code, Section 347 (a)].

The judgment of the Circuit Court of Appeals for the Eighth Circuit was rendered on February 3, 1943 (R. 69-70), and the petition for rehearing (R. 71-81) was denied on March 3, 1943 (R. 83).

C.

REASONS RELIED ON FOR ALLOWANCE OF WRIT.

1.

In holding that petitioner realized taxable income from the acquisition and subsequent sale of its own stock, the Circuit Court of Appeals has decided a federal question in a way directly in conflict with the controlling decisions of this Court in *Helvering v. R. J. Reynolds Tobacco Co.* (1939), 306 U. S. 110, and *First Chrold Corporation v. Commissioner* (1939), 306 U. S. 117.

2.

In holding that the prior Treasury Regulations dealing with the acquisition and sale by a corporation of shares of its own stock were erroneous, the Circuit Court of Appeals has decided a federal question in a way also in direct conflict with the holding of this Court in *Helvering v. R. J. Reynolds Tobacco Co.*, supra, and *First Chrold Corporation v. Commissioner*, supra.

3.

In holding that the Treasury Department has the power, merely by amending its regulations, to change a construction of a statute which has been given the force of law by Congress by virtue of the repeated re-enactment of the statute without change in the light of a consistent interpretation thereof contained in such regulations over a long period of years, the Circuit Court of Appeals has decided a federal question in a way directly in conflict with the decisions of this Court in *Morrill v. Jones* (1883), 106 U. S. 466; *Helvering v. Janney* (1940), 311 U. S. 189, and *Helvering v. Oregon Mutual Life Insurance Co.* (1940), 311 U. S. 267.

4.

In holding that a corporation can realize taxable income from the acquisition and subsequent sale of shares of its own capital stock, the Circuit Court of Appeals has decided an extremely important question of federal law which, if it has not already been settled, as we contend, by the decisions of this Court in *Helvering v. R. J. Reynolds Tobacco Co.*, supra, and *First Chrold Corporation v. Commissioner*, supra, should be conclusively settled by this Court.

5.

In holding that a ruling or requirement of one branch of the federal government (in this case the Securities and Exchange Commission, which has ruled that the acquisition and subsequent resale by a corporation of its own stock is a capital transaction and requires that any surplus arising therefrom be treated as capital) having regulatory power over a taxpayer with regard to the treatment by it of its securities is not binding upon the Bureau of Internal Revenue, the Circuit Court of Appeals has rendered a decision in conflict with the decisions of the Circuit Courts of Appeals for the Third and Fourth Circuits in *Citizens' National Bank of Orange v. Commissioner* (1935, C. C. A. 4), 74 F. (2d) 604, and *United States v. Beckman* (1939, C. C. A. 3), 104 F. (2d) 260, 264.

6.

In relying on the decisions of this Court in *Morrissey v. Commissioner* (1937), 296 U. S. 344; *Helvering v. Wilshire Oil Co.* (1939), 308 U. S. 90, and *Helvering v. Reynolds* (1941), 313 U. S. 428, as being applicable to the case at bar, the Circuit Court of Appeals has misinterpreted the true holdings of those decisions and has thereby added to the general confusion as to the scope of the power of the Treasury Department to amend its regulations under varying circumstances, and in so doing has, among other things, completely failed to note the important distinction between legislative and interpretative regulations, and between amendments which merely amplify or clarify a recognized construction and those which attempt to change an interpretation which has acquired the force of law. The entire subject of regulatory powers of administrative agencies in general, and of the Treasury Department in particular, is in a state of considerable confusion (as recently observed by this Court

in *Helvering v. Griffiths* (1943), ... U. S. ..., 63 Sup. Ct. 636, 87 L. Ed. Adv. Op. 597, l. c. 611) and is a federal question of extreme importance which should be clarified and settled by this Court.

7.

In upholding the Commissioner's contention that petitioner was here dealing in its own shares as it might in the shares of another corporation, while at the same time conceding that the stock of no other corporation could possibly have served the purpose for which these shares were acquired and sold, the Circuit Court of Appeals has sanctioned the emasculation of the express language of the revised regulation, and in doing so has erroneously decided an important question of federal law which has not been but which should be decided by this Court.

D.

PRAYER FOR WRIT.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the causes entitled and numbered on its docket, Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, v. Edison Brothers Stores, Inc., Respondent, No. 12,250, Tax Review, and Edison Brothers Stores, Inc., Petitioner, v. Guy T. Helvering, Commissioner of Internal Revenue, Respondent, No. 12,251, Tax Review; that the judgment of the Circuit Court of Appeals for the Eighth Circuit in said causes may be reviewed

by this Honorable Court; and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

Respectfully submitted,

EDISON BROTHERS STORES, INC.,

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April 10, 1943.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

I.

OPINIONS OF THE COURT AND BOARD BELOW.

The opinion of the United States Circuit Court of Appeals for the Eighth Circuit is not yet officially reported, but is set out on pages 56-68 of the Record. The opinion of the United States Board of Tax Appeals is reported in 45 B. T. A. 472 and appears in the Record at pages 26-34.

II.

JURISDICTION.

A concise statement of the grounds on which the jurisdiction of this Court is invoked appears under the headings B and C in the petition for certiorari, ante, and in the interest of brevity is not repeated here.

III.

STATEMENT.

A concise statement of the case containing all that is material to the consideration of the questions presented, including a summary of the questions presented, the respondent's position and the position of the petitioner, is set out under heading A of the petition for certiorari, ante, and in the interest of brevity is not repeated here.

IV.

SPECIFICATION OF ERRORS.

1. The Circuit Court of Appeals erred in holding that petitioner realized taxable income within the meaning of Section 22 (a) of the Revenue Acts of 1934 and 1936 from the sale of its own stock to its employees in 1935 and 1937.

2. The Circuit Court of Appeals erred in holding that petitioner was not entitled to a deduction in 1935 in the amount of the fair market value of the shares of its own stock which it transferred to its general counsel in payment for services rendered.

3. The Circuit Court of Appeals erred in failing to hold that the sale or other disposition by a corporation of shares of its own previously acquired capital stock is a purely capital transaction resulting in the acquisition of capital and not income.

4. The Circuit Court of Appeals erred in failing to hold that a corporation realizes no taxable gain or loss from the purchase and sale of its own stock.

5. The Circuit Court of Appeals erred in holding that Article 22 (a)-16 of Treasury Regulations 86 and 94 were intended to change the prior, well settled construction of Section 22 (a) with respect to the sale of treasury stock.

6. The Circuit Court of Appeals erred in failing to hold that the prior construction of Section 22 (a), having been given the force of law by Congress, could be changed only by action of Congress, and that therefore the revised regulations, to the extent that they do purport to change the established meaning of Section 22 (a), are invalid.

7. The Circuit Court of Appeals erred in holding that petitioner was dealing in its own stock as it might in the shares of another corporation, within the meaning of Article 22 (a)-16 of Treasury Regulations 86 and 94.

8. The Circuit Court of Appeals erred in reversing the decision of the Board of Tax Appeals with respect to the year 1935 and in affirming the decision of the Board with respect to the year 1937.

9. The Circuit Court of Appeals erred in failing and refusing to decide that there are no deficiencies in petitioner's income tax for either of the years involved.

V.

POINTS AND AUTHORITIES.

1.

In holding that petitioner realized taxable income from the acquisition and subsequent sale of its own stock, and that the prior regulations dealing with transactions of that character were erroneous, the decision of the Circuit Court of Appeals is directly in conflict with applicable decisions of this Court.

Section 22 (a) of the Revenue Acts of 1928, 1932, 1934 and 1936;
Articles 542 and 563 of Treasury Regulations 45 through Articles 66 and 176 of Treasury Regulations 77;
Helvering v. R. J. Reynolds Tobacco Co. (1939), 306 U. S. 110;
First Chrold Corporation v. Commissioner (1939), 306 U. S. 117;
Irwin v. Gavit (1925), 268 U. S. 161, 166;
Douglas v. Willcuts (1935), 296 U. S. 1, 9;
Helvering v. Clifford (1940), 309 U. S. 331, 334;
Koshland v. Helvering (1936), 298 U. S. 441, 445.

2.

In holding that the Treasury Department has the power, merely by amending its regulations, to change a valid, long-settled construction of a statute which has been given the force of law by Congress, the decision of the Circuit Court of Appeals directly conflicts with other applicable decisions of this Court.

Helvering v. R. J. Reynolds Tobacco Co. (1939), 306 U. S. 110;
Helvering v. Winmill (1938), 305 U. S. 79, 83;
Helvering v. Oregon Mutual Life Insurance Co. (1940), 311 U. S. 267;
Helvering v. Janney (1940), 311 U. S. 189;
Morrill v. Jones (1883), 106 U. S. 466.

3.

In holding that the acquisition and subsequent sale by a corporation of shares of its own capital stock can result in taxable income, the Circuit Court of Appeals has decided an important and fundamental question of federal constitutional law which, if it has not already been decided, as we contend, by this Court, should now be decided by this Court.

Helvering v. R. J. Reynolds Tobacco Co. (1939), 306 U. S. 110;
Koshland v. Helvering (1936), 298 U. S. 441, 445.

4.

In holding that a ruling or requirement of a branch of the federal government having regulatory powers over a taxpayer with regard to the treatment by it of its securities is not binding upon the Bureau of Internal Revenue, the Circuit Court of Appeals has rendered a decision in conflict with decisions of other Circuit Courts of Appeals on this question.

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Citizens Nat. Bank of Orange v. Commissioner (1935, C. C. A. 4), 74 F. (2d) 604, 605;
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5.

In relying on certain decisions of this Court which petitioner believes to be inapplicable to this case, the Circuit Court of Appeals has added to the confusion surrounding the important question as to the scope of power of administrative bodies to amend their interpretative regulations,

which question should be clarified and settled by this Court.

Helvering v. Griffiths (1943), ... U. S. ..., 63 Sup. Ct. 636, 87 L. Ed. Adv. Op. 597, 611;
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Helvering v. Wilshire Oil Co. (1939), 308 U. S. 90;
Helvering v. Reynolds (1941), 313 U. S. 428.

6.

In holding that petitioner was dealing in its own shares as it might in the shares of another corporation, the Circuit Court of Appeals has sanctioned a distortion of the clear language and intent of the Treasury Regulations which should be rectified by this Court.

Article 22 (a)-16 of Treasury Regulations 86 and 94;
D. N. & E. Walter & Co. v. Commissioner, 1942 B. T. A. Memo. (C. C. H.—B. T. A. Service, Decision 12,576-B).